

## **TESTIMONY OF AMELIA PORGES**

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U.S. Senate Committee on Foreign Relations  
Subcommittee on East Asian and Pacific Affairs

Senator Murkowski and members of the Subcommittee, my name is Amelia Porges. I am an attorney in the Washington D.C. office of the law firm Sidley Austin Brown & Wood LLP, where I specialize in international trade matters. I speak today in a private capacity, not on behalf of my law firm and not on behalf of any client. I have been asked to provide my perspective on trade issues and the overall trade environment between the United States and Japan.

The trade relationship between the United States and Japan is of major importance to the world economy and to the United States. In 2004, Japan was the third largest purchaser of U.S. exports, following our NAFTA partners, with \$54.4 billion in imports from the United States. Japan was the fourth largest source of U.S. imports after Canada, China and Mexico, with \$129 billion in exports to the United States. The United States is Japan's leading agricultural supplier and Japan is the second largest market for U.S. agricultural exports.

This is a bilateral trade relationship that has greatly changed over the last twenty years, as the Japanese economy has changed and the overall world environment for trade has changed. The United States and Japan have changed the way they deal with each other in that time. They settle their disputes in the WTO, although some issues remain for the bilateral agenda. They negotiate with and against each other in the WTO. Last week, the Business Roundtable joined with its Japanese counterpart Keidanren and counterparts from Europe, Canada, Mexico and Australia to underline the urgent need to reinvigorate the Doha Round negotiations and set a high level of ambition for the agreements in agriculture, non-agricultural market access, services, and trade facilitation.

The border barriers that featured twenty years ago have been largely displaced by the structural issues that can be seen in this year's Japan section in USTR's annual report on trade barriers – postal privatization, broadband utilization, energy sector reform, reform in the financial sector, regulatory reform, corporate law reform and others. These issues have been discussed in depth between the two governments in the U.S.-Japan Regulatory Reform and Competition Policy Initiative established by President Bush and Prime Minister Koizumi in 2001. What is most striking about the October 2004 report of this group is the cross-cutting nature and technical difficulty of the issues it has taken on. These issues can be more difficult to resolve, because they affect broad groups within the Japanese economy, not just specific import-competing interests. But because regulatory reform may also benefit broad groups within Japan, those groups may be a source of support for reform, and reform can have a broader and deeper effect in the long run, both for Japan and the United States and indeed the global economy.

The change in the trade agenda reflects Japan's difficult decade of economic stagnation, from which Japan finally appears to have emerged. It also reflects change in the economic fundamentals. Years ago, Japan imported raw materials and made them into manufactured goods which were exported to the United States and Europe. Today's picture is different and

more complex. Japanese direct exports to the United States have declined as Japanese firms have invested in production bases in the United States, Asia and Mexico. They export parts and components to these manufacturing operations, and then supply their local customers, re-export finished goods to Japan, or export them to other markets. Japan's economy is becoming more and more connected to China's. China is now the largest exporter to Japan, and Japan's second largest export market after the United States. As an outgrowth of the globalization of its trade, and as a way to exert leadership in East Asia, Japan has now launched its own program negotiating "economic partnership agreements", first with Singapore and more recently with Mexico, the Philippines, Thailand, Malaysia and South Korea.

U.S. firms are participating in the Japanese market as investors as well. Foreign direct investment in Japan has been steadily increasing, although from a low absolute base. In 2004, U.S. firms' foreign direct investment in Japan surged to over six times the inflow in 2003, and over 11 times the inflow in 1989. Also in 2004, 65% of all of Japan's FDI was from the United States – primarily in financial services and insurance. But some issues still remain. Cross-border M&A remains more difficult than in other markets; while there have been attempts at hostile takeovers, such as this year's try by the Internet company Livedoor to take over the radio network Nippon Broadcasting System, none of those attempts has been successful.

And so, while the U.S. trade deficit continues to grow, the U.S. bilateral trade deficit with Japan in 2004 was less than half the size of the bilateral trade deficit with China. The goods deficit with China has been increasing and the deficit with Japan has been decreasing; although U.S. exports to China are growing and could soon outstrip U.S. exports to Japan. Where Japan used to have the largest number of pages devoted to it in the USTR trade barriers report, today the focus is China.

The prospects for Japan's regulatory reform efforts were enhanced by Prime Minister Koizumi's huge victory in the Lower House Diet elections on September 11. Since January, the Prime Minister had threatened to dissolve the Lower House if his postal privatization package was rejected, and after it was rebuffed by the Upper House of the Diet, he delivered on his promise. He succeeded in making the election into a referendum on postal privatization and economic reform. The Prime Minister now has a mandate, and a majority firm enough to pass postal privatization even over the objections of the Upper House.

For Prime Minister Koizumi's team, the driving force behind postal reform is not competition in postal delivery – that is only incidental – but putting to more efficient use the immense assets of the postal system and shrinking the civil service. Japan Post now includes not just delivery, but also a postal bank that is the world's largest bank by far, and a postal life insurance company that is bigger than its four largest private competitors combined. His package of six privatization bills, submitted to the Diet on Monday, September 26, would corporatize these entities under a holding company, and require the holding company to sell 2/3 of its own stock and all of the stock in the bank and life insurance companies within a 10-year period starting on October 1, 2007.

What happens after postal privatization? Prime Minister Koizumi stated his priorities in his September 26 policy speech to the Diet. He will privatize the postal complex, which has been the entry point for funds flowing to public works. He also promises to reform government

financial institutions, reduce subsidies by four trillion yen, transfer revenues to local government, further reduce the size and cost of government by civil service reform and outsourcing of functions, and reduce the budget deficit. The next topic is reform of social security, including pensions, health care and long-term care, to meet the needs of Japan's increasingly aging population – almost 20 percent of Japanese are over 65, this percentage will rise to 29% in 2025, and the population is predicted to peak in 2006 and steadily decline from then on. He also pledges to advance Japan's bilateral FTAs, work "tirelessly" toward achieving agreement in the Doha Round, pursue a Security Council seat for Japan, fight terrorism, and build "future-oriented friendly relations based on mutual understanding and trust" with China and Korea.

The keynote is reform: as Prime Minister Koizumi asserts in his speech, "Without reform there is no tomorrow. Without the support of the people reform cannot be achieved. The engine for these reforms is each and every one of the people of Japan." The outcome of these structural reform initiatives remains to be seen. The United States's potential economic interest in their success, however, is greater than its stake in the sector-specific issues that characterized the US-Japan relationship in the past. For this reason, the progress of this reform will be worth watching for this Subcommittee and for others interested in U.S.-Japan relations.

Thank you, Senator Murkowski. I would be pleased to answer any questions.